

FEDERALISM

02 Canadian Federalism Compared to
Other Federal Regimes

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CANADIAN FEDERALISM COMPARED TO OTHER FEDERAL REGIMES

AN OUTLINE OF VARIOUS OTHER FEDERAL SYSTEMS THAT MAY BE COMPARED TO THE CANADIAN "STYLE" OF FEDERALISM.

INTRODUCTION

Approximately half the world's population lives in a federal regime of one type or another. These federal systems are diverse and undergo changes in various directions. Not one of them can be said to be quite the same; but having a common core of concepts, they can be compared.

To help you understand Canada's present political issues, the three documents assembled here may be of some assistance. They do not deal only with Canada's type of federalism as such, but rather contain comparisons relating it to other federal systems.

The first document is a comparative study of federalism as a political framework amenable to a variety of expressions and capable of complex contextual and historical adaptation. A detailed study of the Swiss federal system follows, with references pointing to similarities and differences with the Canadian regime. Finally, included is a study of the European Economic Community dealing with public finance and showing that the integration currently taking place represents a significant change in what has often been referred to as the Common Market's pre-federal phase. Reference is again made to other federal regimes, notably that of Canada.

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- ✓2. Hayes, John A., Federal-Provincial Relations Office, **Federalism and Constitutional Review in Switzerland** (Extracts), Ottawa, June 1975.
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* The complete text is available upon request from the Canadian Unity Information Office.

The documents contained in this kit are taken from various sources and do not necessarily reflect the Government of Canada's point of view

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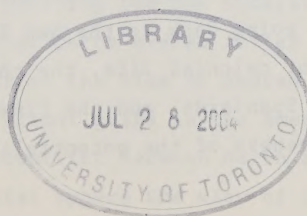
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Extracts from Federal Theory and the "New Federalism", by Maurice Vile a paper given at the Canadian-European Workshop on Comparative Federalism at Queen's University, The Canadian Political Science Association, August 1977.

These extracts give explanations of the federal systems of the United States, Australia, Switzerland, West Germany and Canada.



DEVELOPMENTAL MODELS OF FEDERAL STATES

The complexity of the particular style of decentralized state which we label as "federal" can be understood only if we construct a set of development models of states which, at one time or another, have approximated to the central mean of federality. Each state may move towards that mean and then away from it; each will have its own pattern of development; each will have its own particular combination of relationships between the levels of government in the differing institutional structures. Such a model for the United States would show how that country has moved from a territorially-oriented, highly decentralized system with a high degree of mutual independence of the two levels of government, combined with only the absolute minimum of the interdependence necessary to maintain the fabric of the federation, to the highly pluralistic structure of today in which the relative independence of the two levels has changed considerably, with the federal government in a dominant position of leadership, but with a high degree of interdependence between the levels of government, particularly in the political structures, such that it is very different from a centralized state like France or the United Kingdom. The stages of the development of the United States along this long path can be sketched as follows:

Stage 1. To 1789. The Pre-Conceptual Stage

The achievement of the Federal Constitution required a long and difficult preparation going back to the New England Confederation of 1643. The pressures of colonial life, the threat of the Indians, fears of the French and the Spaniards, and the final conflict with Britain, together with the awareness of the potentialities of the undeveloped

American continent, all these gave birth to a latent nationalism, weak at first and fragile, brought to fruition by the War of Independence. This sense of being "American" provided the minimum basis for the acceptance of the "federal bargain",¹¹ but particularistic loyalties were still extremely strong. The result was a compromise which created a Federal Government with little more than the minimum powers necessary for survival. The Constitution created political institutions which embodied the two essential aspects of the federal State - a sufficient degree of independence for the Federal Government and the States, together with the essential links between the two levels to make them interdependent as well: the composition and powers of the Senate, the working of the Electoral College, the role of the States in the elections to the House and the Senate, and the participation of the States in the process of constitutional amendment.

Stage 2. 1789-1860. The Contractual Stage

The constitutional fabric of federalism was created in 1787, but in the other areas of inter-governmental relationships there was a long slow process of development to come. The development of American national identity was a complex process, particularly when the immediate threats of foreign intervention faded, and the United States was left in almost undisputed control of much of the North American continent. Each section of the country in turn resisted the exercise of national power when it conflicted with its immediate interests. The Federal Constitution was seen by many as a contract which could be renounced if the other partners exceeded the terms of the bargain.

The "first party system", as W.N. Chambers has described it, performed an essential function in grafting the new Federal Government into the fabric of politics, but that party system failed and national politics almost disintegrated. After the rise of Andrew Jackson the "second party system" bridged the sectional gulfs in the American system until it too failed to resolve the conflict between North and South.¹² In the administrative and financial sphere the view of Leonard D. White

that in the early period of the Union, the States and the Federal Government "had little to do with each other" ¹³ has been rebutted by Daniel Elazar, who has written that "at any given time in American political history the great majority of governmental activities was shared by all levels of government, and that "co-operative federalism was the rule in the nineteenth century as well as in the twentieth". ¹⁴ There is certainly a wealth of evidence to demonstrate that the complete separation of the spheres of Federal and State government activity was not characteristic of the working of American federalism at any time after 1789. However, the "co-operative" element of Federal-State relationships, important as it was before 1860, has to be set within the overall context of the constitutional and political character of Federal-State relationships in the period, and much of this reflected conflict rather than co-operation. It will be argued later that the use of the term "co-operative federalism" as a blanket term can be just as misleading as the blanket term "dual federalism" against the use of which, quite rightly, scholars were reacting. The fact is that in this period there were many co-operative ventures between Federal and State governments, but, unlike the system which was to develop in the twentieth century, there was little or no recognition of the role of the Federal Government as an equalizing force in the political system - the "co-operative federalism" of the first half of the nineteenth century was of a different order from that of the period which began in 1932.

Stage 3. 1860-1865. The Critical Stage

The conflict between national allegiance and particularistic loyalties had to be resolved at some point. In the United States it was the Civil War which removed beyond all doubt any contractual element in the federal bargain. State and sectional loyalties were not destroyed by the outcome of the Civil War but the limits of the extent to which they could be pushed was clearly set. The Civil War was the furnace in which the American national identity was hardened. Such a process is by no means limited to the development of nationalism in federal states. Bri-

tain, France and many other countries have undergone this kind of bloody integrative process before their citizens became aware of their common identity. In rather different circumstances the Swiss federation grew to maturity out of a long history of conflict, and the sobering experience of Nigeria has emphasized the extent of this problem in a developing country. There are of course exceptions to this sad rule, but the exceptions tend to be found in countries, like Australia for example, which are extensions of an already well-established national identity - the "critical stage" of Australian federalism was perhaps the attempted secession of Western Australia in the 1930's, fortunately a bloodless conflict.

Stage 4. 1865-1932. The Period of Consolidation

The Civil War was decisive in terms of the development of American national consciousness, and from that point on the evolution of nationalism can be clearly chartered, but the result was not by any means the creation of a unitary state. On the contrary it was only in the period following the Civil War that the United States approximated closely to the central point of balance in the federal model. The Federal Government was securely established in its independence, but the States had not yet come under the influence of the Federal Government in the way which was to develop after 1932. The political parties performed the function of linking and co-ordinating the two levels of government so that though the Federal, State, and indeed the local governments enjoyed a high degree of autonomy, they did not operate in water-tight political compartments. Many aspects of this party system with its bosses and machines, its spoils and its corruptions are extremely unattractive, but it did perform the functions required in the federal state and performed them very well. This was, of course, a period of relative inactivity of governments in the social and economic life of the country. The leaders of the developing industrial and commercial community wished to be left to get on with their work without the tiresome meddling of governments, and the federal system was used as a way of minimising go-

vernment action - the constitutional theories of "dual federalism" were exploited to the full to this end. Nevertheless it was a vital period for the expansion of the United States and for the slow, gradual evolution of a sense of community such that when the Depression came, the psychological basis had been created for a very different system of government to emerge.

Stage 5. 1932-1965. The Integrated Federation

In the thirty years following the election of Franklin Roosevelt the federal system was transformed from a machine to prevent government action, into one which built together the levels of government into a complex mechanism for the reconciliation of the enormous variety of plural interests in the United States. It was a period which saw the rapid decline of particularism and sectionalism, and their replacement by group politics in which geographical factors played an important, but by no means decisive role. The reality of the achievement of American nationhood was worked out, not just by the common interest in defence, but through the gradual but continuous assertion of the rights of Americans to an equal share in the benefits of government. This was reflected in every aspect of the working of the political system - in the development of constitutional law which culminated in the enforcement by the Supreme Court of the "equal protection of the law" clause of the Fourteenth Amendment, in the "nationalization" of the party system, and in the use of a wide range of administrative and financial techniques to implement social and economic programmes. The structures of federalism remained, but they were transformed into a system of institutionalized pluralism.

Stage 6. 1965- The Unitary-Federal State?

The integrated federal system, born of the Depression, began to change gear into something rather different as a result of the vast Federal programmes that were undertaken during President Johnson's Adminis-

tration in the years 1964-6. The number, size and character of the grant-aided programmes which were initiated in those years outstripped in significance for the Federal system, the programmes of the New Deal era.¹⁵ The Federal Government entered into direct relationships with local governments and community groups in a way which it had never done before. If Morton Grodzin's conception of a "marble-cake federalism"¹⁶ offered a rather exaggerated picture of the degree of interpretation of the different levels of government for earlier periods of federalism, it was certainly becoming true by the end of the 1960's. More helpful perhaps than the "marble-cake" image is the comparison with the European conception of "administrative federalism", or to borrow the term "unitary-federal State" from the description by Konrad Hesse of West Germany as ein unitarischer Bundesstaat. More and more the United States was becoming a system of government in which all major fields of government action the Federal Government laid down policies, sometimes in considerable detail, and the States and localities were required to implement them, usually under close Federal supervision.

During this period the constitutional issue seems to have been settled almost conclusively in favour of the exercise of national power wherever and whenever the Congress judges it to be necessary in the national interest;¹⁷ the administrative and financial power of the Federal Government is potentially overwhelming. In three of the four structures of intergovernmental relationships hardly any real balance remains - whatever is left of State independence and discretion seems to be largely at the discretion of the Congress. It is hardly surprising that Michael Reagan should ask "Is Federalism Dead?" and that he concludes that federalism "in the classic conception" is indeed dead.¹⁸ And yet it is still true that the United States has a far more decentralized political system than say Britain or France, and that the processes of integration have still yet not produced quite a "unitary-federal" State on the European model. What are the major factors which have created the situation?

Firstly it is the result of the stage of development of American national consciousness in the 1970's, and the particular character of that national consciousness. This particular character is its unique blend of diversity and uniformity. In many ways American society is the most diverse, the most mixed in the world in terms of its religious and ethnic composition, and yet it is also in some ways the most uniform of any society of its size and geographical extent. What makes the United States so different from other large plural societies is the fact that there are now no really clearly-definable territorial sub-cultures in the United States of the kind that are to be found in the "older" countries of Europe and Asia. Different groups which might be called sub-cultures surely exist, the black population for example, but these groups are not associated with a particular State, or even a particular region, to the extent that would be necessary for genuine and powerful local allegiances to persist. The "melting-pot" has not destroyed ethnic and social differences, but it has certainly spread them pretty evenly across the continent. Modern communications, the mobility of the population and the erosion of historic sectionalism by the heavy immigration during the last years of the nineteenth century and the early years of the twentieth, have all contributed to this "dispersed" character of the social groupings in America. The South was the last of the historic sections to yield to these forces, but clearly it is now doing so. There is no historical basis in the United States for an equivalent to Scottish or Breton nationalism, nothing to compare with the solidarity of the Flemings in Belgium, nothing comparable to Quebec. There is a sense in which the United States has the potentiality for becoming a single nation to an extent which is impossible to the older nations of Europe, which carry within themselves the seeds of their own destruction, the remains of even older, temporarily suppressed, nationalism. To quote Reagan "We have at least become one nation, indivisible, and if justice

for all is to be achieved it will not be by leaving its definition to the dominant factions of small areas."¹⁹ Thus if federalism as a concept is inextricably territorial or geographical as Duchacek and Dikshit assert,²⁰ then the United States is no longer a federal State. However, such a conclusion would be hasty - let us look at the remaining structure of relationships, the political parties and pressure-groups.

The American party system is extremely decentralised. Indeed it is no exaggeration to say that it is more decentralised, more fragmented today than it was at the beginning of the century. A number of factors have combined to produce this result - the end of bosses and machine politics, the rise of the American welfare state, and the destruction of party organisation by the system of primary elections. American party leaders today, presidential and congressional, formal and informal, have less real power and influence than a Woodrow Wilson, Marc Hanna or a Joe Cannon. Thus today the Federal Government rides unsurely upon a vast, shifting, shapeless pattern of State and local politics - the strength of the national authority lies in the fact that it has no effective competitor for power,, but its weakness lies in the fact that it can itself only act effectively by obtaining the consent and the co-operation of political forces scattered throughout the nation.

This is the reality underlying American pluralism, and it means that in the sphere of party and group action the interdependence of Federal, State and local governments is very high indeed. Thus the great potential for exercise of central power in the constitutional, administrative and financial spheres is drastically modified by the pluralistic character of politics - the machinery of central domination is there, but there is no one to operate it.

A COMPARATIVE PERSPECTIVE

I have examined the development of American federalism in some detail in order to draw out some of the problems of analysis presented by the literature. It is not suggested for a moment that this pattern of development portrays some kind of "ideal" to which other federal systems ought to adhere, or that there is a necessary and determined path along which all true federal systems must tread. On the contrary it is clear that other systems of government, such as West Germany for example, have had very different origins and a very different character. Nevertheless other countries can be analysed in the same way in order to examine the particular mix of variables in the system, and the way that that mix changes and evolves under the pressures of changing circumstances and developing national consciousness. There will be certain common factors operating upon all modern systems of government - pressures towards the recognition of social needs by governments, pressures towards greater government intervention and control in order to guarantee equality of treatment to all citizens, and at the same time increasing fears of the effects of overcentralised bureaucratic power. But there will also be many local factors which distinguish the paths of development of particular countries - the history and environment of the State, above all the nature and extent of the social cleavages within it and the particular kind of national consciousness which has emerged as a result. The latter will be critical in determining the exact combination of the exclusive, competitive, co-operative and compliance relationships to be found in the system, and the particular balance of mutual independence and interdependence between the levels of government in the four main structures of the political system.

To attempt such an analysis of federal systems other than the United

States would be far beyond the scope of this paper, and also beyond the competence of the author, but a few observations upon some of the countries where there has been active discussion of some kind of "New Federalism" might be of value. If the nature and significance of the "New Federalism" in the United States is related to the particular circumstances of the development of American national consciousness, then we would expect that the country or countries closest to the United States in this respect would most closely resemble it in terms of such developments, and we can indeed see the way in which the differences in emphasis in various countries reflect their different parts of development.

The closest comparison with the American situation comes, hardly surprisingly, from Australia. Not only was the Australian Constitution closely modeled upon the American pattern of federalism but the nature of Australian society, and its development, exhibit very important similarities to American development. The Australian States do not represent distinct cultural communities with a historic consciousness of linguistic or ethnic differences. If anything, they exhibit less particularistic loyalty than their American counterparts. During much of its history the developing Australian nation was an extension of the British national consciousness and had a more homogeneous composition than American society. Since the Second World War immigration into Australia has had a similar effect upon the political situation as it has had in the United States, in the sense that it has introduced a more pluralistic quality into that society, but one which tends to mute the historical differences between the States. It is not surprising, therefore, that the drive for political egalitarianism appeared earlier in Australia than in the United States, and that it has gone much further. Thus in spite of constitutional obstacles, or perhaps because of them, Australia developed a whole range of unique institutions to link the Commonwealth and State governments and to equalize the provision of services between

States. Financial integration, the dependence of State governments for their revenue upon the Federal government, and explicit machinery for providing equalization grants to the States came to Australia well before similar developments elsewhere.

Thus all the elements of the complex Federal-State relationships analysed above are to be found, with local variations in style and emphasis, in Australia also. The tension between the desire for political egalitarianism on the one hand, and for freedom from excessive central control is just as great, indeed exacerbated by the more ideological and more highly organised and centralised nature of the Australian party system. Thus there has also been a discussion in Australia of a "New Federalism" but with a difference. At the same time that Mr. Nixon was developing his conception of a new federal system as a counter-attack to centralisation, to roll back the influence of the Federal Government, the Labour Prime Minister of Australia, Mr. Whitlam was using a similar terminology but with a rather different aim. Mr. Whitlam's "New Federalism" was in fact a further development towards integrating the efforts of Commonwealth and State governments in order to improve the overall performance of Australian government in tackling economic and social problems. Mr. Whitlam's critics saw this as an increase in the compliance element in the Federal-State relationship, certainly not a devolutionary move of the Nixon variety.²⁴

Mr. Whitlam's successor, Mr. Fraser, reacted with proposals for a "new New Federalism" much more along American lines, with a clear devolutionary intent. The most important proposal was to replace the general revenue grants made by the Commonwealth Government to the States by "tax-sharing" arrangements. The irony of the Australian-American comparison is that the Nixon revenue-sharing proposals involved the allocation of block grants to the American States with few strings attached, in other words a system not too dissimilar to the general revenue grants which

had been made for over thirty years to the Australian States by the Commonwealth Government to compensate them for the loss of their income-tax revenues which had been forcibly appropriated by the Commonwealth under the Uniform Tax Plan. The Australian devolutionary proposals, however, involved a return of tax sources to the States in order to bring political responsibility and financial accountability more into line. The same central dilemma remains, with an endless game of "musical chairs" in an attempt to find a solution.

If we turn to the discussion of "the New Federalism" in two quite different federal systems, Switzerland and West Germany, we find that similar terminology is being used, but that their meaning in those countries is rather different. Gunther Kisker writes of "the New Federalism" and "co-operative federalism" as synonymous²⁵ in West German terms, although of course the devolutionary Nixon proposals and the centralising effects of co-operative and compliance techniques are quite different. Kooperativer Federalismus must be understood within the German context of a very different federal system from that of the United States or Australia. German federalism starts from a much more highly centralised concept of the role of the Bund, with the Lander, for the most part being concerned with the administrative application of laws created by Bundestag, the Federal Parliament. The Lander, with the exception of Hamburg and Bavaria do not represent distinctive historic communities, they "reflect at most a number of regional variations in a basically homogeneous society".²⁶

The major areas in which the Lander do exercise important legislative powers are education, police and the general structure of local government, although in recent years the Bund has moved into the sphere of education as well. "Co-operative federalism" therefore in German terms means inter-authority co-operation between the Lander, which is very important: it means the co-ordination of the policies of Bund and

Lander through the Bundesrat and through a variety of links between the main issues of the two levels of government; it means co-operation through the ability of the Bund to pass "framework laws" under Article 75 of the Basic Law, the details of which are filled in by the Lander; and it means institutional co-operation in the performance of Gemeinschaftsaufgaben (community task) under Article 91A.²⁷

Administrative federalism of this kind presents a very different set of relationships between the levels of government from the "Anglo-Saxon" federations, and a very different balance between independence and interdependence. Nevertheless there is a high degree of interdependence built into the German system, particularly through the role of the Bundesrat, and in recent years a great deal of attention has been focused upon this aspect of the institutional structure. As Gerhard Lehmbuch points out, it is here that the intersection of the party system and the federal system can result in either a relatively harmonious collaboration, or at worst, in complete deadlock.²⁸

In recent writings on Swiss federalism there has also been a tendency to use "the New Federalism" and "co-operative federalism" as interchangeable terms. Switzerland provides an example of a society in which evidence is to be found of far more potentially socially divisive factors than in the United States, Australia or West Germany. Diversities of language, religion, culture and *économies* qualify Switzerland as a "segmented society",²⁹ certainly not a term which could be applied to the other three. Fortunately the cleavages within Swiss society do not all coincide; on the contrary they cut across each other, and so mediate the conflicts which inevitable arise in such a situation.³⁰ As a result the federal system has operated as a mechanism through which the interests of the various sections of the community are effectively represented in the decision-making process. In comparison with other modern states the complex decision making processes in Switzerland, and the

variety of the interests involved, could be said to have resulted in a high degree of immobilisme. Certainly enormous efforts have to be made before programmes can pass into law and be effectively implemented.

Although the Swiss federal system was originally based upon the same principle of division of powers as the American model, there has been a progressive concentration of legislative power in the Federal Government, but the execution of laws has largely been left to the cantons, as Germann puts it, as a kind of "compensation" for their loss of legislative authority.³¹ Thus the Swiss federation has become rather more like the West German model, a system of "administrative federalism", which puts a great deal of strain upon the cantons, differing widely as they do in their size and resources. It is this problem of Vollzugsfederalismus which has been the centre of attention of Swiss scholars in recent years in an attempt to find co-operative and inter-authority co-operative techniques to overcome this difficulty.³²

Thus in the United States, Australia and West Germany we find that in spite of many differences between them there are remarkable similarities arising out of the degree of national integration which they have achieved, and the way in which all three are faced with the problems of adapting complex institutional structures to the conflicting demands of egalitarianism and autonomy. If Germany has not yet been faced with the same demand for new devolutionary techniques to be adopted it is perhaps because it is more used to a centralist system, and because the kind of administrative federalism that it operates does give a significant degree of autonomy to the Lander in the implementation of policy. The Swiss situation is rather different because of the cleavages within Swiss society, but when we turn to the example of Canada we find a very different situation. Of all the countries that we have looked at here, Canada has the least integral national consciousness. To all the diversities arising from geographical and economic factors is added the crucial one which all others lack, a clearly defined area containing a distinct linguistic and cultural entity - Quebec.

The complexity of the forces acting upon the Canadian federation since 1867 defy a short summary. The attachment of simple labels to long periods of the history of complex societies, which we found to be so inadequate in the case of "dual federalism" and "co-operative federalism" in the United States, is doubly inappropriate in the Canadian situation. Thus Edwin Black has chartered five competing concepts of federalism which have been important in Canadian history, overlapping and reacting upon each other.³³ What is certain is that genuine devolutionary developments have taken place in Canada in recent years in a way which, whatever political rhetoric has been used, just has not happened elsewhere. The nature of the Canadian political process puts far more emphasis upon the mutual independence of the Federal and Provincial levels than in any other countries we have discussed, and although there is a political interdependence between these levels it is of a very different kind from the American or Australian variety. Thus Richard Simeon has explained the recent history of policy making in Canada in terms of a diplomatic relationship between the Federal and Provincial Governments.³⁴ This diplomacy is carried on by the elite groups, like the high contracting parties at international bargaining tables, rather than through the kind of integrated relationship between Federal and State officials to be found in the United States, or between the officials of Bund and Lander in West Germany. "The New Federalism" in Canadian terms then, has a concrete meaning, because the movements towards fiscal decentralisation that have been taking place reflect a higher priority on regional autonomy than on national political egalitarianism. Canada, perhaps, is the only example we can give of "the New Federalism" being more than a rather ineffectual protest against the seemingly inevitable consequences of national integration in the modern industrial state.

Footnotes

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EXTRACTS FROM
FEDERALISM AND CONSTITUTIONAL REVIEW
IN SWITZERLAND

JUNE 1975

The following extracts are taken entirely from the federal government's original document. The text was prepared by John A. Hayes, Federal-Provincial Relations Office, Ottawa.

NOTE: The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the Federal-Provincial Relations Office.



June 30, 1975

FEDERALISM AND CONSTITUTIONAL
REVIEW IN SWITZERLAND

1. FEDERALISM IN SWITZERLAND

It is a common impression in Canada that Switzerland is a loosely-bound association of sovereign states which have delegated a limited number of functions to a central authority, functions which they can, perhaps, withdraw at will. This is far from being an accurate picture. The principal characteristics of the Swiss political and federal systems are as follows:

1. Switzerland is not a confederacy but a true federal state. The Federal Constitution imposes severe limits on the autonomy of the twenty-five individual cantons and half cantons; more severe, probably, than the limits imposed by the Canadian Constitution on the autonomy of the provinces. The Swiss Federal Constitution may be amended by a simple majority. It is, however, a "double majority": a majority of the people who vote in Switzerland as a whole; and a majority of cantons, which means that the vote is counted separately in each of the cantons and half cantons, to determine whether in a minimum of eleven and a half cantons (two half cantons being counted as one) there is a majority in favour of the amendment.
2. The Constitution of 1848, which transformed the confederacy into a federation, was not, for all cantons, a pact of voluntary association. It was

in fact, imposed upon some of the catholic cantons defeated in the preceding Sonderbund civil war. All cantons were given an opportunity to approve the Constitution. Six and a half at first rejected it; three and a half of those who rejected it never did formally accept the decision of the majority.

3. There has been and still is as much concern in Switzerland about defining and limiting the role of the state as with dividing this role among the three levels of jurisdiction. The devices of popular control of government known collectively in Switzerland as "direct democracy" play a key role in the political system. Amendments of the Federal Constitution must be submitted to a national vote; and they may be initiated by any group which can collect 50,000 signatures. Federal legislation is subject to an optional referendum, whereby any given piece of legislation must be submitted to a national vote if so requested by at least 30,000 voters. At the cantonal and commune (municipal) levels the controls of direct democracy are even more extensive. Most increases in tax rates, most legislation, and most large individual investment projects must be submitted to a separate popular vote.
4. Subject to the controls of direct democracy, which were further extended in the total revision of the Constitution in 1874, the Constitution of 1848 set out to create a strong central authority; and since 1848 there has been through successive constitutional amendments a continual transfer of powers from the cantonal authorities to the centre, a trend which has accelerated in recent years. The trend would probably have been even more marked if Switzerland had experienced unemployment rather than a continuous

shortage of labour since 1947. Switzerland's small size and its division into a large number of cantons, combined with the nature of a number of the problems confronting the modern state, have been among the factors behind this trend towards greater power for the central authorities. However, in the last few years there have been increasing expressions of concern about the need to preserve a meaningful degree of autonomy at the canton and commune levels. This, and the shortage of tax resources at the disposal of the federal authorities, may slow but probably will not reverse the trend.

5. As a result, the central legislature and executive in Switzerland have relatively more power and influence than do the Canadian Parliament and Government vis-à-vis the legislatures and executives of the constituent states. An important difference, however, is that in Switzerland the central legislature, the Federal Assembly, is composed of two houses with equal powers, the "upper house" containing two representatives elected from each canton. Members of the upper house do not act on the instructions of the cantonal authorities. They are in almost all cases elected directly by popular vote. It is they, along with members of the lower house, who rather than members of cantonal governments represent cantonal interests in questions of national concern.
6. Thus, when one speaks of federalism in Switzerland one has in mind as much the question of local influence on the central decision-making apparatus as the question of the area of autonomy reserved for the cantons and communes. Such local influence is strong. It is exercised not only through members

of the two houses of the Federal Assembly, but in other ways as well, such as through the highly-developed "consultation process" which precedes the introduction of federal legislation.

7. The Swiss system of government is based on the doctrine of the separation of powers. Although the executive, the Federal Council, is elected by the Assembly from among the Assembly's members, once elected it is separate, and Federal Councilors relinquish their seats in the Assembly.
8. Political power is dispersed more widely in Switzerland than in Canada. There are several reasons:
 - (a) Direct democracy limits the power of legislatures and governments at all levels.
 - (b) While because of point (a) and other factors the Federal Council and the Federal Assembly are, taken together, less of a political force than the Canadian Government and Parliament, the separation of powers gives a relatively greater share of the power to the legislature vis-à-vis the executive than is the case in Canada.
 - (c) Interest groups of various kinds, both those which have a permanent organization and those which are organized on an ad hoc basis, are able to influence decisions in important ways. Business, labour, agricultural, recreational and other groups have their representatives among the members of the militia-type, part-time Federal Assembly; and since such groups can easily collect sufficient signatures to force a national referendum on items of federal legislation, the federal government is careful to consult with them about legislative proposals.

- (d) No one political party dominates the others, largely because legislators are elected by the system of proportional representation.
 - (e) The seven members of the Federal Council customarily include nominees of all of the major parties, in roughly the same proportions as the parties are represented in the Federal Assembly.
 - (f) The Federal Council may not dissolve the Assembly, both being elected for a fixed term, and party discipline in the Assembly is weak, giving members a good deal of independence. It is not infrequent that a majority of one or other of the two houses votes against the Federal Council's proposals, and such votes are not interpreted as an expression of lack of confidence in the executive. On the other hand, Federal Councillors once elected enjoy a fair measure of independence from the Assembly and from party control.
9. This wide dispersal of political power, combined with the effect of long-standing traditions, mean that political decisions in Switzerland at all levels of government have to be taken on the basis of a broad consensus; and more effort has to be put into the forming of such a consensus than is the case in Canada.
10. The dispersal of power has important implications for the operation of federalism in Switzerland. Because of it, and notably because executives cannot count upon the support of legislatures, intergovernmental negotiation is not a principal characteristic of the Swiss as it is of the Canadian federal system. The cantonal governments do participate in the consultation process, but for the most part not very

actively or effectively. Members of cantonal governments may, however, as individuals have an important input. Several of them sit in one or other of the two houses of the Federal Assembly, as do several members of the commune governments; and some key party members may hold office at national, cantonal and commune levels. This "role accumulation" promotes an information flow that helps to integrate local and national politics.

11. Federalism is, therefore, more of a diffused concept in Switzerland than it is in Canada. Since it does not focus on intergovernmental negotiations, federal-cantonal relations are less vital to the operation of the federal system, and it is possible to carry them on in a "low-key" fashion.
12. There is in the Constitution little in the way of protection for linguistic minorities against possible arbitrary measures on the part of the majority language group. The area of local autonomy assured by the Constitution to the cantons has been progressively reduced; and the double majority which is the arbiter of further transfers of power to the centre could, in theory, be used to serve the advantage of the majority language group. The real protection for minorities lies in certain habits and traditions which have developed in Switzerland, and in the fact that the country, when it divides on issues, rarely does so on the basis of language alone; there are many "cross-cutting cleavages" which militate against polarization on the lines of language. The several French-speaking cantons of Suisse Romande do not consider themselves one nation.
13. Linguistic minorities receive consideration at the federal level and, generally speaking, at the

cantonal level as well; they feel secure; and they participate fully in the political, economic and cultural life of the country. They have on the whole approved or acquiesced in the continual transfer of functions to the centre. These functions, once transferred, may be exercised by the Federal Assembly through legislation which is subject only to the approval of a "single majority" of voters (a majority of cantons is not required) in an optional referendum.

14. The diffused nature of Swiss federalism, and the fact that minority language groups feel relatively secure, mean that the question of the division of functions and revenues between the federal and cantonal authorities can be discussed without the survival of language groups becoming a highly emotional aspect of the discussion, as it sometimes is in Canada.

To summarize, the Swiss political and federal systems resemble those of the United States more than those of Canada. There is, in common with the United States, the separation of powers (although they are "more separate" in the United States); the bicameral central legislature elected for a fixed term with strong representation of local interests; and a large number of constituent states. There are, on the other hand, important differences from the United States: the pervasive nature of direct democracy and the more limited role of the state; the collegiate executive elected not directly but by the legislative assembly; frequent constitutional amendments; strong municipal governments with better sources of revenues and with few direct relations with the central authorities; the existence of three major language groups; and, evidently, the size of the population and of the country itself.

2. THE CURRENT REVIEW OF THE SWISS FEDERAL CONSTITUTION:

SUMMARY.

Since the late nineteen sixties the Swiss federal government has been conducting studies with a view to a possible total revision of the Federal Constitution. It is pertinent to ask how important, relatively, is the written Constitution in the Swiss political system; why the review studies were launched; what is their scope; who is carrying them out; what are the principal issues being examined; and what is the prospect of a total revision being implemented.

The Swiss Federal Constitution is in a sense a more important document, relatively, than the British North America Act. It covers a number of matters which in Canada are left to custom and convention, and, in some cases, to legislation. The Swiss Federal Constitution is also continually in the public eye, because every year the public is being asked to vote on one amendment or another. Any total revision will involve the Swiss public in a more extensive way than a revision of the British North America Act would involve the Canadian public, because the individual Swiss citizen will be called upon to vote for or against any new constitutional text, something that the Canadian citizen is not asked to do.

There are differing views on the necessity for a total revision, which would be the first since 1874. The argument proceeds among intellectuals rather than among the public at large, because it is not a political issue in Switzerland. Those who are inclined to oppose a total revision, or who at least doubt that one is necessary, argue in part as follows:

1. Individual amendments to the Constitution can be made relatively easily, as and when required.
2. There is no major problem in Switzerland today which requires a total revision for its solution.

3. There is no popular pressure for a total revision.
4. Carrying out a review is an excuse to defer necessary changes, whether in the Constitution or in other aspects of government.

Those who favour a review argue that:

1. There are certain problems which can only be dealt with in the context of a total revision, because of the inter-relationships among various parts of the Constitution.
2. Such problems include the excessive power of certain groups, the lack of "transparency" in the political decision-making process, and the threat to personal freedom posed by both governments and other wielders of power. As a practical matter, it will be necessary, in resolving these problems and making these changes, to satisfy a number of different groups and interests, and this will be easier to do through a "package deal" involving several parts of the Constitution. (It is, however, not clear that popular approval is in fact easier to obtain for "packages" than for a series of individual amendments).
3. There are some technical changes and updating required which can best be introduced through a total revision. The Constitution needs to be made more readable and intelligible to the citizen -- who is so often asked to vote changes -- and the opportunity could be taken to set forth some of the great principles and objectives of government, to guide citizens and governing authorities.

The constitutional review was, in fact, prompted by intellectuals, but the need for it was accepted by the Federal Assembly, and the Federal Council authorized the review without, however, any commitment as to the desirability of a total revision. The reasons put forward at the time (it was 1965) as to why a review was necessary concerned not so much the

distribution of functions between the federal authorities and the cantons, as what was called the "Helvetisches Malaise", a feeling that Swiss political institutions were out of date and that Switzerland was in danger of falling behind the rest of Europe. More recently, the distribution of functions has acquired added importance, but it still ranks no higher than other questions such as the appropriate limits of direct democracy and the effectiveness of federal government institutions.

The scope of the constitutional review is very broad, and includes such basic questions as the purpose and limits of a constitution. It is the intention to relate the present studies to the major political and social issues of the day.

Because of the particular nature of Swiss federalism, and the fact that the ultimate arbiter of constitutional change is the double majority of direct democracy, inter-governmental negotiation was never even considered as a way to proceed with the review. Instead, the frequently-used method of an expert commission was chosen. The preliminary studies, between 1967 and 1972, were carried out on the instructions of the Federal Council by a small working group of about ten people. The terms of reference were to determine whether a total revision was desirable. The working group concluded that one was, in fact, desirable. It is necessary to note, however, that the composition, method of study, and conclusions of the group have frequently been criticized.

The second phase of the studies was launched in 1974 with the creation of a Commission of Experts, forty-six in number, under the chairmanship of the Federal Councillor for Justice and Police. It is composed of members of the Federal Assembly, university professors, journalists, and so on. It includes several members of cantonal governments, designated by the federal Department of Justice and Police. Most of the earlier working group are also included. The Commission of

Experts, not all of whom agree that a total revision is desirable, have been asked to present their report to the Federal Council by the end of 1977, after which the Federal Council is itself expected to take a position on the need for a total revision and, if it believes one is needed, on the content of such a revision.

There are a large number of questions being examined by the Commission of Experts, but permeating the list are four major issues:

1. The degree of control exercised by the citizen over the federal Parliament and executive.
2. The preservation of a certain degree of autonomy for cantons and communes.
3. The effectiveness of the federal authorities, particularly the Federal Council.
4. The fairness and "transparency" of the federal decision-making process, particularly with regard to the influence of organized interest groups.

One major subsidiary question is that of a possible change in the basis of representation of the federal upper house to make some concession to the principle of "representation by population". This is likely to be a most controversial issue if it is ever submitted to a national vote. Such a proposal would involve the prospect of a smaller voice for the cantons with small populations in the deliberations of the Federal Assembly; it would also implicitly raise the question of whether, in counting the "majority of cantons" in national votations on constitutional amendments, there should not also be some adjustment for differences in population among the cantons.

Pervading all these questions is a search for balance: between state and citizen, between federal and cantonal authorities, and among the various interests in the community.

It is generally recognized that getting national approval for a totally revised text will be extremely difficult. It is at least possible that once the Federal Council has received the report of the Commission of Experts in 1977 it will take some time to sound out public opinion, possibly until after the election campaign of 1979. Following the 1979 elections the Federal Council, if it decides for a total revision, could also decide to recommend to the Federal Assembly and people that the Constitution be amended to permit the election by the people of a Constitutional Council which would review the proposed new text before the people were asked to vote on it. The part-time Federal Assembly would not itself have time to review the text. The final national vote on a new text, if one is to take place, could therefore well be deferred until 1982 or after, seventeen years later than the first formal motions requesting a review were tabled in the Federal Assembly.

Meanwhile, throughout this long process, constitutional amendments are being proposed, both by Parliament and by popular initiative, and voted upon in increasing numbers. There are also concurrent official shorter-term studies on the distribution of functions and revenues as between the federal and cantonal authorities. The Commission of Experts, therefore, has to integrate these current developments into its own longer-term studies.

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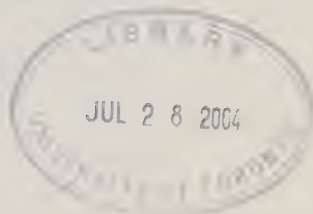
COMMISSION OF THE EUROPEAN COMMUNITIES

EXTRACT FROM
REPORT
OF THE STUDY GROUP ON
THE ROLE OF PUBLIC FINANCE
IN EUROPEAN INTEGRATION

Volume I : General Report

Brussels

April 1977



This report has been prepared by a group of independent experts set up by the Commission. The opinions expressed in this report remain the sole responsibility of the group and not that of the Commission and its services.

PREFACE

At the end of 1974 the Commission asked a group of independent economists (Professors Biehl, Brown, Forte, Fréville, O'Donoghue and Peeters, and Sir Donald MacDougall as Chairman) to examine the future rôle of public finance at the Community level in the general context of European economic integration.

The Study Group held fourteen meetings from April 1975 to March 1977. Officials of several Directorates-General of the Commission also took part in these meetings (Economic and Financial Affairs, Regional Policy, Budget, Financial Institutions and Taxation). The Group also had the benefit of discussions with two expert consultants from the United States (Professor Oates) and Australia (Professor Mathews).

The results of the work are presented in two volumes. This first volume contains the General Report, including an Introduction and Summary, all of which have been unanimously agreed by the members of the Study Group.

The General Report draws heavily on the much larger body of evidence and analysis contained in the second volume.⁽¹⁾ This consists of individual contributions by the members of the Study Group, and the two expert consultants from the United States and Australia. It also contains working papers contributed at the request of the Group by its secretariat of officials from the Directorate-General for Economic and Financial Affairs of the Commission. While the authors of the individual chapters in the second volume take final responsibility for them, they have all benefitted from detailed discussion by the Group as a whole.

(1) Referred to in the General Report by chapter numbers in square brackets.

INTRODUCTION AND SUMMARY

Free trade in goods and services within the Community of Nine has been largely achieved, although significant non-tariff barriers remain in both the industrial and the agricultural fields. Monetary union, on which much has been written, is - for reasons given by the Marjolin Committee(1) - a long way off and will probably have to await major developments in the political, monetary and fiscal fields. This report examines the third main element in economic union, largely neglected so far, namely the role of public finance, which we take to embrace not only taxation and public expenditure, but also the many regulatory, co-ordinating and non-budgetary activities in the economic field in existing economic unions.

A major part of our work has been a detailed and quantitative study of public finance in five existing federations (Federal Republic of Germany, U.S.A., Canada, Australia, Switzerland) and three unitary states (France, Italy and the U.K.) - eight countries in all - and in particular the financial relationships between different levels of government and the economic effects of public finance on geographical regions within the countries. We have also studied a good deal of the voluminous theoretical literature on "fiscal federalism". The main purpose has been to see what light these studies throw on future developments in the public finances of the European Community.

It is most unlikely that the Community will be anything like so fully integrated in the field of public finance for many years to come as the existing economic unions we have studied. Nevertheless, we believe that our analysis helps to throw light on the ways in which the public finance activities of the Community might be expanded and improved during, say, the next decade. We do not make any definite recommendations (although we describe a possible package, with options, to help focus discussion); but we hope that the orders of magnitude we present will help to put the political debate on these matters in perspective, that our analysis will help those who have to decide the direction in which Community expenditures (and revenues) might be extended, and that it will also help those who have to determine which of the many possible techniques would be most appropriate: our analysis of other countries provides a rich treasure house of experience - including mistakes to be avoided.

(1) Report of the Study Group "Economic and Monetary Union 1980", Brussels, March 1975.

Main points from study of eight countries and existing Community

The most relevant orders of magnitude and other facts are as follows:

1. Public expenditure by members of the Community in 1975 was about 45 % of the gross product of the area as a whole (this is the weighted average for the individual states). Expenditure by all Community Institutions is 0.7 % (10 billion units of account in 1977).
2. Although the statistical problems are considerable, it can be said with a fair degree of certainty that per capita incomes are in general at least as unequal between the Nine members of the Community (and between the 72 regions we have distinguished in the Community) as they are on average between the various regions of the countries we have studied, even before allowing for the equalising effects of public expenditure and taxation.
3. These reduce regional inequalities in per capita income by, on average, about 40 % in the countries studied (by more in Australia and France, by less in the U.S.A. and Germany). The redistributive power between member states of the Community's finances, by comparison, is - not surprisingly - very small indeed (1 %); partly because the Community budget is relatively so small, partly because the expenditures and revenues of the Community have a weak geographical redistributive power per unit of account.
4. The redistribution through public finance between regions in the countries studied tends to be reflected to a large extent (though not, of course, precisely because other factors are involved) in corresponding deficits in the balances of payments on current account of the poorer regions, with corresponding surpluses in the richer regions. These deficits and surpluses are of a continuing nature. Net flows of public finance in the range of 3 - 10 % of regional product are common for both relatively rich and relatively poor regions, but a few of the latter enjoy considerably higher net inflows, up to around 30 % of regional product.
5. As well as redistributing income regionally on a continuing basis, public finance in existing economic unions plays a major role in cushioning short-term and cyclical fluctuations. For example, one-half to two-thirds of a short-term loss of primary income in a region due to a fall in its external sales may be automatically offset through lower payments of taxes and insurance contributions to the centre, and higher receipts of unemployment and other benefits. If only because the Community budget is so relatively very small there is no such mechanism in operation on any significant scale as between member countries, and this is an important reason why in present circumstances monetary union is impracticable.

6. The importance of the various instruments which effect inter-regional redistribution varies. On the tax side, personal income tax is, in most countries, the predominant instrument. The main public expenditure programmes and social security systems also tend to have substantial redistributive effects.

In unitary states a large part of the total redistribution between regions arises automatically in these ways and is in a sense "invisible"; high incomes go with high tax payments and low incomes with high receipts of centrally provided services and transfer payments. (Regional policy narrowly defined is relatively unimportant).

In federal countries intergovernmental grants and tax-sharing play a much more important part. These achieve relatively large redistributive results with relatively small amounts of federal expenditure, because the net inter-regional transfers are to a smaller extent than elsewhere the result of differences between large payments in opposite directions.

7. In the federal countries, leaving aside defence and external relations including aid, which are always a federal responsibility, as much as one-half to two-thirds of civil expenditure is left in the hands of lower levels of government, sometimes including most expenditure on education, health, houses and roads, although social security is normally a predominantly federal responsibility. On the other hand, the financing of the expenditure is much more a federal responsibility - to the extent of one-half to four-fifths.
8. The difference is reflected in grants from federal to lower levels of government; and the variety of techniques used - general purpose grants, specific purpose grants, matching grants, etc. - has been carefully analysed with a view to drawing lessons for the Community.
9. As regards the distribution of the main taxes between levels of government in the federations, there are few general rules except that customs duties are always federal, property tax always local or state, and social security contributions (or social insurance) mostly federal, except in the United States. For personal and corporate income tax, general sales tax and excises, there is a broad range of practices.

Implications for the future role of public finance in the Community

It is possible to conceive, presumably at some distant date, a Federation in Europe in which federal public expenditure is around 20 - 25 % of gross product as in the U.S.A. and the Federal Republic of Germany.

An earlier stage would be a federation with a much smaller federal expenditure of the order of 5 - 7 % of gross product, or roughly $7\frac{1}{2}$ - 10 % if defence were included. An essential characteristic of such a federation would be that the supply of social and welfare services would nearly all remain at the national level. Such an arrangement could provide sufficient geographical equalisation of productivity, living standards and cushioning of temporary fluctuations to support a monetary union. But there are various degrees of confidence as to whether this would in practice be feasible.

In our Report we have tended to concentrate more on what we call "pre-federal integration", a period during which it is assumed that the Community's political structure is being gradually built up, partly with the direct election of the European Parliament. We can envisage public expenditure at Community level rising to around, say, 2 - $2\frac{1}{2}$ % of gross product during this period.

In considering which expenditure functions might be carried out to a greater extent at Community level we have taken account, in addition to the experience of the eight countries studied, and political realities as we assume them to be, the following criteria.

First, the case for Community involvement where this can achieve "economies of scale", including greater bargaining power vis-à-vis third countries. This applies mainly to external relations (where it is a reality in external trade; a partial reality, which might be extended, in aid to developing countries; a possibility in energy and political co-operation; not at present a possibility as regards the supply of the defence services, although this does not rule out ad hoc co-operation between individual members). There are also possible economies of scale in Community action on advanced technology, industrial and technical standards, etc.

Secondly, there is a case for Community involvement when developments in one part of the Community "spill over" into other parts of it, or indeed all of it. Several of the external functions already referred to as achieving economies of scale also have major spillover effects. An important example, internal to the Community, during the "pre-federal integration" stage will, in our view, be Community action in the areas of structural and cyclical policies (regional, manpower, unemployment) to ensure so far as possible that the benefits of closer integration are seen to accrue to all, that there is growing convergence - or at least not widening divergence - in the economic performance and fortunes of member states. Those measures should make a start in reducing the inequalities in per capita incomes between the various parts of the area; the situation in the eight countries studied tends to confirm that this is a necessary part of economic union.

Thirdly, we assume that most member governments are reluctant at the present time to see any significant increase in total public expenditure at all levels - Community, national, state and local - as a percentage of gross product. This means that, besides curbing our ambitions for the Community, we must look for transfers of expenditure from national to Community levels, especially where economies of scale can be achieved; for savings where possible in existing Community expenditures (for example agriculture, which at present comprises two-thirds of the Community budget); for the most cost-effective methods of achieving the objectives described in the previous paragraph; and avoidance of regulations, harmonisation, etc. which are not worth-while in terms of the extra bureaucratic and other costs involved.

Changes in the Community's expenditure

In the light of these various considerations, and to provoke discussion by those responsible for action, we would suggest the following main directions in which the Community's expenditure might be changed during the "pre-federal integration" phase.

- (a) The Community is already, and will increasingly on present plans become, involved in development aid. There is scope for transfers from national to Community level of some 2 - 4 billion units of account. This could achieve economies of scale by reducing administrative costs for recipient and donor countries and increasing the value of aid received by spreading the choice of procurement over a wider area.
- (b) We would not see a case at this stage - though circumstances may change - for significant Community involvement in social and welfare services, which make up well over one-half of member states' total public expenditure, except for unemployment and vocational training - see (e) (ii)-(iii) below. The Community has an interest in such matters as standards of teaching of European languages, mutual recognition of examination standards and reciprocity in health services and social security, but these will not involve large amounts of public money.
- (c) We would look for savings wherever possible, for example in agriculture and, less important quantitatively, through economies of scale in, for example, advanced technology, common political representation in smaller third countries, etc.
- (d) In industrial sectors other than agriculture, for which Community intervention is established or plausible (e.g. steel, fisheries, energy, certain declining industries), the amount of direct budgetary subsidies should not tend to become large. But, not to be confused with budgetary expenditure, much larger sums of parallel loan financing, borrowed by the Community on capital markets or under Community guarantee, might be appropriate in some cases.

(e) It is in the area of structural, cyclical, employment and regional policies that we see the main need for substantial expenditure at Community level. The purpose of these measures is mainly to help to reduce inter-regional differences in capital endowment and productivity. Our general report sets out a "menu" of six possibilities.

(i) More Community participation than at present in regional policy aids (employment or investment incentives, public infrastructure, urban redevelopment).

(ii) More Community participation than at present in labour market policies (including vocational training and other employment measures).

(iii) A Community Unemployment Fund on the lines suggested in the Marjolin Report under which part of the contributions of individuals in work would be shown as being paid to the Community and part of the receipts of individuals out of work as coming from the Community. This need not necessarily involve any increase in total public expenditure or contributions in the Community as a whole. Apart from the political attractions of bringing the individual citizen into direct contact with the Community, it would have significant redistributive effects and help to cushion temporary setbacks in particular member countries, thereby going a small part of the way towards creating a situation in which monetary union could be sustained.

(iv) A limited budget equalisation scheme for extremely weak member states to bring their fiscal capacity up to, say, 65 % of the Community average and so ensure that their welfare and public service standards are not too far below those of the main body of the Community.

(v) A system of cyclical grants to local or regional governments that would depend upon regional economic conditions.

(vi) A "conjunctural convergence facility" aimed at preventing acute cyclical problems for weak member states leading to increasing economic divergences.

We judge that a selection from these six possibilities, or variants of them, involving budgetary expenditure of the order of 5 - 10 billion units of account per annum on average could be regarded as beginning to be economically significant. A 10 billion unit of account packet could reduce inequalities in living standards between member states by about 10 %, compared with the average of about 40 % in the countries studied, and might be judged an acceptable start.

Where grants are involved in the above possibilities (other than the suggested Unemployment Fund) they should be made as cost-effective as possible. This could involve, for example, the use of specific purpose matching grants (the Community providing a share of the total cost); having variable matching ratios, e.g. between 80 % and 20 % for poorer and richer states or regions so that the money went where it was most needed; and possibly the attachment of macro-economic performance conditions (on inflation, monetary policy, etc.) to some of the grants, to increase the likelihood that they would increase economic convergence.

The net cost of the suggestions under (a) - (e) above, allowing for savings, economies of scale, and mere transfers of expenditure from national to Community level, as well as for the hopefully favourable effects on the growth and stability of the Community's gross product, should not increase total public expenditure in the Community at all levels as a proportion of real product by much more than a percentage point. Allowing for the transfer of expenditure from national to Community level, the Community budget might rise from 0.7 % to around 2 - 2½ %.

Financing

This would, nevertheless, raise a problem of financing, because on likely present policies the Community will approach the limit of its existing financial capacity (customs duties, agricultural levies and not more than 1 % of VAT on a common base) towards the end of the decade, and without assuming any new policy developments with significant budgetary implications such as we have suggested, modest as they may be.

The Group has therefore considered what the Community's next resources might be. Most possible candidates are either inadequate in size or raise serious practical difficulties. We therefore suggest as one source of finance a further tranche of VAT resources on the present approximately neutral basis after adjustment by the "Financial Mechanism". But we also suggest in addition a more progressive revenue source. Drawing on principles followed in Canada and Germany this could be a variant built onto the VAT system with adjustments based on a formula using a progressivity key such as personal income tax capacity.

Stabilisation

We have considered whether the Community budget could or should be used as an instrument for helping to stabilise short-term and cyclical fluctuations in economic activity. We conclude that this would be very limited in the "pre-federal integration" period. With a budget of the order of 1 % - 2½ % of gross product the budget balance would have to swing by enormous percentage fractions of this budget to have a perceptible macro-economic effect on activity in the Community as a whole;

and to allow this would also weaken the link in the minds of politicians between public expenditure and the need to pay for it over a period of years by taxation. In any case, some would hold that budgetary deficits and surpluses would have only limited effects unless they were linked with a coordinated Community monetary policy.

We would, however, favour limited powers of borrowing (and repayment) to prevent the need for a Community budgetary policy that actually accentuated cyclical movements, by forcing tax increases or expenditure cuts in recession years and vice versa. We would also favour specific countercyclical policies under (e) (iii), (v) and (vi) above - the Unemployment Fund; cyclical grants to local or regional governments; a "conjunctural convergence facility".

Conclusion

In conclusion, we hope that the analysis in our Report will be of some assistance to those who will be debating, and taking decisions on, these hitherto rather neglected public finance aspects of economic union. We should also like to think that the detailed chapters supporting the general report will for a considerable time be an important work of reference to which will turn for guidance, and even inspiration, those who have to analyse, advise on, and deal with, the many problems relating to public finance that we believe are bound to come up quite frequently in the years ahead.

Finally, we should like to pay tribute to the superb, original, professional work by the Secretariat which has supported our deliberations. To a large extent our Group has been in the nature of a Steering Committee of a number of highly qualified researchers, without whose expert and devoted work this Report could never have been produced.



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